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DEPARTMENT OF TREASURY

Office of the Comptroller of the Currency

12 CFR Part 3

Docket ID OCC-2014-0025

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FEDERAL RESERVE SYSTEM

12 CFR Part 217

Regulation Q; Docket No. R-1502

RIN 7100-AE 24

FEDERAL DEPOSIT INSURANCE CORPORATION

12 CFR Part 324

RIN 3064-AE 12

Regulatory Capital Rules: Regulatory Capital, Proposed Revisions

Applicable to Banking Organizations Subject to the Advanced Approaches

Risk-Based Capital Rule

AGENCIES: Office of the Comptroller of the Currency, Treasury; the Board of Governors of the Federal Reserve System; and the Federal Deposit Insurance Corporation.

ACTION: Joint notice of proposed rulemaking (NPR).

SUMMARY: The Office of the Comptroller of the Currency (OCC), the Board of Governors of the Federal Reserve System (Board), and the Federal Deposit Insurance Corporation (FDIC) (collectively, the agencies) are seeking comment on an NPR that would clarify, correct, and update aspects of the agencies' regulatory capital rule applicable to banking organizations that are subject to the advanced approaches risk-based capital rule (advanced approaches banking organizations). The proposed revisions are largely driven by observations made by the agencies during the parallel-run review process of advanced approaches banking organizations. They are also intended to enhance consistency of the U.S. regulations with international standards for use of the advanced approaches rule.

DATES: Comments must be received no later than [INSERT DATE 60 DAYS FROM DATE OF PUBLICATION IN FEDERAL REGISTER].

ADDRESSES: Comments should be directed to:

OCC: Because paper mail in the Washington, DC area and at the OCC is subject to delay, commenters are encouraged to submit comments by the Federal eRulemaking Portal or e-mail, if possible. Please use the title “**Regulatory Capital Rules: Regulatory Capital, Proposed Revisions Applicable to Banking Organizations Subject to the Advanced Approaches Risk-Based Capital Rule**” to facilitate the organization and distribution of the comments. You may submit comments by any of the following methods:

- **Federal eRulemaking Portal—“regulations.gov”**: Go to <http://www.regulations.gov>. Enter “Docket ID OCC-2014-0025” in the Search Box and click “Search”. Results can be filtered using the filtering tools on the left side of the screen. Click on “Comment Now” to submit public comments.
- Click on the “Help” tab on the Regulations.gov home page to get information on using Regulations.gov, including instructions for submitting public comments.
- **E-mail**: regs.comments@occ.treas.gov.
- **Mail**: Legislative and Regulatory Activities Division, Office of the Comptroller of the Currency, 400 7th Street, SW., Suite 3E-218, Mail Stop 9W-11, Washington, DC 20219.
- **Hand Delivery/Courier**: 400 7th Street, SW., Suite 3E-218, Mail Stop 9W-11, Washington, DC 20219.

- **Fax:** (571) 465-4326.

Instructions: You must include “OCC” as the agency name and “Docket ID OCC-2014-0025” in your comment. In general, OCC will enter all comments received into the docket and publish them on the Regulations.gov Web site without change, including any business or personal information that you provide such as name and address information, e-mail addresses, or phone numbers. Comments received, including attachments and other supporting materials, are part of the public record and subject to public disclosure. Do not enclose any information in your comment or supporting materials that you consider confidential or inappropriate for public disclosure.

You may review comments and other related materials that pertain to this rulemaking action by any of the following methods:

- **Viewing Comments Electronically:** Go to <http://www.regulations.gov>. Enter “Docket ID OCC-2014-0025” in the Search box and click "Search". Comments can be filtered by Agency using the filtering tools on the left side of the screen.
- Click on the “Help” tab on the Regulations.gov home page to get information on using Regulations.gov, including instructions for viewing public comments, viewing other supporting and related materials, and viewing the docket after the close of the comment period.

- **Viewing Comments Personally:** You may personally inspect and photocopy comments at the OCC, 400 7th Street, SW., Washington, DC. For security reasons, the OCC requires that visitors make an appointment to inspect comments. You may do so by calling (202) 649-6700. Upon arrival, visitors will be required to present valid government-issued photo identification and to submit to security screening in order to inspect and photocopy comments.
- **Docket:** You may also view or request available background documents and project summaries using the methods described above.

Board: When submitting comments, please consider submitting your comments by e-mail or fax because paper mail in the Washington, DC area and at the Board may be subject to delay. You may submit comments, identified by

Docket No. R-1502 and RIN 7100 – AE 24, by any of the following methods:

- Agency Web Site: <http://www.federalreserve.gov>. Follow the instructions for submitting comments at <http://www.federalreserve.gov/apps/foia/ProposedRegs.aspx>.
- Federal eRulemaking Portal: <http://www.regulations.gov>. Follow the instructions for submitting comments.
- E-mail: regs.comments@federalreserve.gov. Include docket number in the subject line of the message.
- Fax: (202) 452-3819 or (202) 452-3102.

- **Mail:** Robert de V. Frierson, Secretary, Board of Governors of the Federal Reserve System, 20th Street and Constitution Avenue, NW., Washington, DC 20551.

All public comments are available from the Board's website at <http://www.federalreserve.gov/apps/foia/ProposedRegs.aspx> as submitted, unless modified for technical reasons. Accordingly, your comments will not be edited to remove any identifying or contact information. Public comments may also be viewed electronically or in paper form in Room MP-500 of the Board's Martin Building (20th and C Streets, NW., Washington, DC 20551) between 9:00 a.m. and 5:00 p.m. on weekdays.

FDIC: You may submit comments, identified by RIN 3064-AE 12, by any of the following methods:

Agency Website:

<http://www.fdic.gov/regulations/laws/federal/propose.html>.

Follow instructions for submitting comments on the Agency website.

- **E-mail:** Comments@fdic.gov. Include the RIN 3064-AE 12 on the subject line of the message.
- **Mail:** Robert E. Feldman, Executive Secretary, Attention: Comments, Federal Deposit Insurance Corporation, 550 17th Street, NW., Washington, DC 20429.

- **Hand Delivery:** Comments may be hand delivered to the guard station at the rear of the 550 17th Street Building (located on F Street) on business days between 7:00 a.m. and 5:00 p.m.

Public Inspection: All comments received must include the agency name and RIN 3064-AE01 for this rulemaking. All comments received will be posted without change to <http://www.fdic.gov/regulations/laws/federal/propose.html>, including any personal information provided. Paper copies of public comments may be ordered from the FDIC Public Information Center, 3501 North Fairfax Drive, Room E-1002, Arlington, VA 22226 by telephone at (877) 275-3342 or (703) 562-2200.

FOR FURTHER INFORMATION CONTACT:

OCC: Margot Schwadron, Senior Risk Expert (202) 649-6982; or Mark Ginsberg, Principal Risk Expert (202) 649-6983, Capital Policy; or Carl Kaminski, Counsel; or Kevin Korzeniewski, Attorney, Legislative and Regulatory Activities Division, (202) 649-5490, for persons who are deaf or hard of hearing, TTY, (202) 649-5597, Office of the Comptroller of the Currency, 400 7th Street SW., Washington, DC 20219.

Board: Constance M. Horsley, Assistant Director, (202) 452-5239; Thomas Boemio, Manager, (202) 452-2982; Andrew Willis, Supervisory Financial Analyst, (202) 912-4323, Matthew McQueeney, Senior Financial Analyst, (202) 425-2942, or Justyna Milewski, Financial Analyst, (202) 452-3607, Capital and

Regulatory Policy, Division of Banking Supervision and Regulation; or Christine Graham, Counsel (202) 452-3005; or David W. Alexander, Counsel (202) 452-2877, Legal Division, Board of Governors of the Federal Reserve System, 20th and C Streets, NW., Washington, DC 20551. For the hearing impaired only, Telecommunication Device for the Deaf (TDD), (202) 263-4869.

FDIC: Bobby R. Bean, Associate Director, bbean@fdic.gov; Ryan Billingsley, Chief, Capital Policy Section, rbillingsley@fdic.gov; or Benedetto Bosco, Capital Markets Policy Analyst, bbosco@fdic.gov; Capital Markets Branch, Division of Risk Management Supervision, (202) 898-6888; or Michael Phillips, Counsel, mphillips@fdic.gov; Rachel Ackmann, Senior Attorney, rackmann@fdic.gov; Grace Pyun, Senior Attorney, gpyun@fdic.gov; Supervision Branch, Legal Division, Federal Deposit Insurance Corporation, 550 17th Street, NW., Washington, DC 20429.

SUPPLEMENTARY INFORMATION:

I. Background

In 2013, the Office of the Comptroller of the Currency (OCC), the Board of Governors of the Federal Reserve System (Board), and the Federal Deposit Insurance Corporation (FDIC) (collectively, the agencies) comprehensively revised and strengthened the capital requirements applicable to banking

organizations¹ (regulatory capital framework).² Among other changes, the regulatory capital framework revised elements of the advanced approaches risk-based capital requirements (advanced approaches rule) now located at subpart E of the agencies' revised regulatory capital framework.³

The advanced approaches rule applies to large, internationally active banking organizations, generally those with \$250 billion or more in total consolidated assets or \$10 billion or more in total on-balance sheet foreign exposure, depository institution subsidiaries of those banking organizations that use the advanced approaches rule, and banking organizations that elect to use the advanced approaches (advanced approaches banking organizations).⁴ Before an advanced approaches banking organization may use the advanced approaches rule to determine its risk-based capital requirements, it must conduct a satisfactory trial, or parallel run.⁵ During the parallel run period, which must be at least four consecutive calendar quarters, an advanced approaches banking organization must demonstrate to the satisfaction of its primary Federal supervisor that it has implemented risk-measurement and risk-management systems that are consistent

¹ The term banking organizations includes national banks, state member banks, state nonmember banks, savings associations, and top-tier bank holding companies domiciled in the United States not subject to the Board's Small Bank Holding Company Policy Statement (12 CFR part 225, appendix C), as well as top-tier savings and loan holding companies domiciled in the United States, except for certain savings and loan holding companies that are substantially engaged in insurance underwriting or commercial activities.

² The Board and the OCC issued a joint final rule on October 11, 2013 (78 FR 62018) and the FDIC issued a substantially identical interim final rule on September 10, 2013 (78 FR 55340). In April 2014, the FDIC adopted the interim final rule as a final rule with no substantive changes. 79 FR 20754 (April 14, 2014).

³ 12 CFR Part 3 (OCC), 12 CFR Part 217 (Board), and 12 CFR Part 324 (FDIC).

⁴ 12 CFR 3.100(b)(1) (OCC), 12 CFR 217.100(b)(1) (Board), and 12 CFR 324.100(b)(1) (FDIC).

⁵ 12 CFR 3.121(c) (OCC), 12 CFR 217.121(c) (Board), and 12 CFR 324.121(c) (FDIC).

with the advanced approaches rule and are appropriate given the banking organization's size and level of complexity. After the primary Federal supervisor determines that the banking organization fully complies with all the qualification requirements, has conducted a satisfactory parallel run, and has an adequate process to ensure ongoing compliance, then the banking organization will be required to use the advanced approaches to calculate its risk-based capital requirements.⁶

Consistent with section 171 of the Dodd-Frank Act,⁷ an advanced approaches banking organization that is required to calculate its risk-based capital requirements under the advanced approaches rule also must determine its risk-based capital requirements under the generally applicable risk-based capital rule.⁸ The lower ratio (i.e., the more binding ratio) for each risk-based capital requirement is the ratio the banking organization must use to determine its compliance with minimum regulatory capital requirements.

In February 2014, the agencies permitted certain banking organizations to exit parallel run and to begin calculating their risk-based capital requirements

⁶ 12 CFR 3.121(d) (OCC), 12 CFR 217.121(d) (Board), and 12 CFR 324.121(d) (FDIC).

⁷ See, 12 U.S.C. 5371.

⁸ Prior to January 1, 2015, the term "generally applicable risk-based capital rules" refers to the risk-based capital rules set forth at 12 CFR Part 3, appendix A and 12 CFR Part 167 (OCC); 12 CFR pt. 208 and 12 CFR Part 225, appendix A (Federal Reserve); and 12 CFR Part 325, appendix A, and 12 CFR Part 390, subpart Z (FDIC). As of January 1, 2015, and thereafter, the term "generally applicable risk-based capital rules" will refer to the risk-based capital rules set forth at 12 CFR Part 3, subparts A, B, C, and D (OCC); 12 CFR Part 217, subparts A, B, C, and D (Board); and 12 CFR Part 324, subparts A, B, C, and D (FDIC).

using the advanced approaches rule, beginning with the second quarter of 2014.⁹ Supervisory review of advanced approaches systems conducted as part of the parallel run exit review process has highlighted certain areas of the advanced approaches rule qualification requirements that would benefit from clarification. In addition, the agencies are proposing to make technical revisions to address typographical errors, such as incorrect references, in the regulatory capital framework. The agencies are also proposing clarifications that are intended to enhance the consistency of the U.S. regulations with international standards for use of the advanced approaches. The proposed amendments in this NPR affect only provisions that apply to advanced approaches banking organizations. The agencies are seeking comment on all aspects of the proposed rule.

II. Proposed Rule Corrections and Clarifications

Since publishing the regulatory capital framework, the agencies have identified typographical and technical errors in several provisions, including provisions of subpart E of the regulatory capital framework. The agencies have also identified provisions that warrant clarification or updating in light of revisions to other rules. The agencies are, therefore, proposing to revise the regulatory capital framework as described below.

Definition of residential mortgage exposure

⁹ This data is reported on the FFIEC 101, Regulatory Capital Reporting for Institutions Subject to the Advanced Capital Adequacy Framework, available at <http://www.ffiec.gov/forms101.htm>.

The definition of residential mortgage exposure in section 2 of the regulatory capital framework was intended to provide that, for purposes of the advanced approaches rule, an exposure secured by a first or subsequent lien on one-to-four family residential property must be managed as part of a segment of exposures with homogenous risk characteristics, and not on an individual basis, to be considered a residential mortgage exposure.¹⁰ Under the advanced approaches, for retail exposures, a banking organization must have an internal system that groups retail exposures into the appropriate retail exposure subcategory and groups the retail exposures in each retail exposure subcategory into separate segments with homogenous risk characteristics.¹¹ As currently written, however, the definition of residential mortgage exposure does not provide that advanced approaches banking organizations must group exposures secured by a first or subsequent lien on one-to-four family residential property into separate segments with homogenous risk characteristics, as required under the retail framework of the advanced approaches. Accordingly, the agencies propose to revise the definition of residential mortgage exposure to provide that, for the purpose of calculating capital requirements under the advanced approaches, any exposure secured by a lien on residential property must be managed as part of a segment of exposures with homogenous risk characteristics, and not on an individual basis, to

¹⁰ This provision is explicit in the regulatory capital framework definition of residential mortgage exposure for an exposure with an original and outstanding amount of \$1 million or less that is primarily secured by a first or subsequent lien on residential property that is not one-to-four family.

¹¹ See 12 CFR 3.122(b)(3) (OCC), 12 CFR 217.122(b)(3) (Board), and 12 CFR 324.122(b)(3) (FDIC).

be considered a residential mortgage exposure. This change would make the definition consistent with the definition used in the 2007 advanced capital adequacy framework implementing Basel II¹² (2007 rule).

Calculation of total on-balance sheet foreign exposure

The criteria set forth in section 100(b) of the regulatory capital framework, which describe which banking organizations are required to use the advanced approaches rule, include an explanation of how a banking organization determines whether it meets the \$10 billion total on-balance sheet foreign exposure threshold. The advanced approaches rule currently references line-item descriptions from a version of the FFIEC 009 Regulatory Report that has since been modified to adjust or rename those line items. The agencies therefore propose to update the methodology for calculating this measure in section 100(b)(ii) to reflect the relevant line-item descriptions and instructions from the most recent version of the FFIEC 009 Regulatory Report.¹³

Disclosure requirements for advanced approaches banking organizations

Section 173 of the regulatory capital framework requires advanced approaches banking organizations that have completed the parallel run process and have received notification from their primary Federal supervisor pursuant to

¹² 72 FR 69288 (December 7, 2007).

¹³ Available at http://www.ffiec.gov/forms009_009a.htm.

section 121(d) of subpart E to provide timely disclosure of the information in the applicable tables in that section.

Table 6 of section 173 of the regulatory capital framework requires firms to explain and review the structure of internal ratings systems and the relation between internal and external ratings. Section 939A of the Dodd-Frank Act generally requires the Federal banking agencies to remove any reference to, or any requirement involving, the reliance on external credit ratings to assess the creditworthiness of a security or money market instrument. As a result, the agencies are proposing to amend table 6 of section 173 to clarify that the use of external ratings is not required for the purpose of an advanced approaches banking organization's internal rating assessment.

For the purpose of the disclosures required in table 6 of section 173, to the extent that the advanced approaches banking organization considers external ratings in its internal ratings process, it must include an explanation of the relation between the internal and external ratings. An advanced approaches banking organization that does not use or consider external ratings would not be required to make such a disclosure.

Table 9 in section 173 of the regulatory capital framework describes information related to securitization exposures that certain advanced approaches banking organizations are required to disclose. In the regulatory capital framework, the agencies revised the risk-based capital treatment of these items,

but did not revise Table 9 to reflect the revisions. The agencies propose to update line (i)(2) under quantitative disclosures to appropriately reflect the current treatment under the regulatory capital framework of credit-enhancing interest only strips (CEIOs) and after-tax gain-on-sale resulting from a securitization. Specifically, under the regulatory capital framework, an after-tax gain-on-sale resulting from a securitization is deducted from common equity tier 1 capital, rather than from tier 1 capital as was the case under the 2007 rule. Also, under the regulatory capital framework, CEIOs that do not constitute after-tax gain-on-sale are risk-weighted at 1,250 percent, rather than deducted from total capital, as was the case under the 2007 rule.

Collateral posted by a clearing member client banking organization and clearing member banking organization

Sections 133(b)(4)(ii) and 133(c)(4)(ii) of the regulatory capital framework require a clearing member client banking organization or a clearing member banking organization, respectively, to calculate a risk-weighted asset amount for any collateral provided to a central counterparty (CCP), clearing member, or custodian in connection with a cleared transaction in accordance with the requirements under section 131. The agencies note that section 131 only provides for the risk-weighting of wholesale and retail exposures whereas collateral posted to a CCP, clearing member, or custodian may also be in the form of a securitization exposure, equity exposure, or a covered position. Therefore, the

agencies are proposing to amend sections 133(b)(4)(ii) and 133(c)(4)(ii) to replace the cross reference to section 131 with a broader cross reference, as applicable, to subpart E, which provides the risk-weighting methodology for wholesale, retail, securitization and equity exposures, or subpart F, which provides the risk weighting methodology for covered positions, so that the clearing member client banking organization and clearing member banking organization can determine the correct risk weight for the collateral provided.

Risk weight for certain client cleared transactions

Under the regulatory capital framework, a clearing member banking organization must assign a 2 percent risk weight to the trade exposure amount for a cleared transaction with a qualifying central counterparty (QCCP) and a risk weight according to section 32 to the trade exposure amount for a cleared transaction with a CCP that is not a QCCP. The definition of cleared transaction includes a derivative contract or repo-style transaction between a CCP and a clearing member banking organization where the banking organization is acting as a financial intermediary on behalf of its clearing member client and the transaction offsets a derivative contract or repo-style transaction between the clearing member banking organization and its client that meets the requirements of section 3(a) of the regulatory capital framework. The agencies are proposing, consistent with the Basel Committee's capital requirements for bank exposures to central

counterparties capital framework,¹⁴ to permit clearing member banking organizations to assign a zero percent risk weight under subpart E to the trade exposure amount of a cleared transaction that arises when a clearing member banking organization does not guarantee the performance of the CCP and has no payment obligation to the clearing member client in the event of a CCP default. In these circumstances, requiring the clearing member banking organization to include a trade exposure amount to the CCP in credit risk-weighted assets would generally result in an overstatement of its total risk-weighted assets under the advanced approaches rule. However, if a clearing member banking organization does guarantee the performance of the CCP to the clearing member client, then a clearing member banking organization would assign a risk weight of 2 percent to its trade exposure amount for a cleared transaction with a QCCP or a risk weight according to section 32 of the regulatory capital framework to its trade exposure amount (as defined in section 133) for a cleared transaction with a CCP that is not a QCCP.

This proposed approach would align the risk-based capital requirements for client-cleared transactions with recently finalized revisions to the treatment of those transactions under the agencies' supplementary leverage ratio rule.¹⁵ When calculating the supplementary leverage ratio, the agencies do not require a clearing member banking organization to include the exposure to the CCP for a client-

¹⁴ Available at <http://www.bis.org/publ/bcbs282.pdf>.

¹⁵ 79 FR 57725, 57735 (Sept. 26, 2014).

cleared transaction in total leverage exposure if the clearing member banking organization does not guarantee the performance of the CCP to the clearing member client.

Application and disclosure of the supplementary leverage ratio

Section 10(c) of the regulatory capital framework requires advanced approaches banking organizations that have completed the parallel run process to calculate the supplementary leverage ratio as described under section 10(c)(4).¹⁶ The agencies are proposing to clarify in this rulemaking that the supplementary leverage ratio described in section 10(c)(4) applies to a banking organization that becomes subject to the advanced approaches pursuant to section 100(b)(1), regardless of the status of its parallel run process. Specifically, the supplementary leverage ratio described in section 10(c)(4) would apply to a banking organization immediately following the quarter in which the banking organization become subject to the advanced approaches pursuant to section 100(b)(1).

Advanced approaches banking organizations are subject to supplementary leverage ratio disclosure requirements described in sections 172 and 173 of the regulatory capital framework.¹⁷ The agencies propose to revise sections 172 and 173 of the regulatory capital framework, consistent with the revisions proposed for

¹⁶ The agencies published a joint final rule in the Federal Register on September 26, 2014 (79 FR 57725) that revised the definition of the denominator of the supplementary leverage ratio (2014 SLR rule) that the agencies had adopted in the regulatory capital framework.

¹⁷ Section 172(d) was added to the regulatory capital framework as part of the 2014 SLR rule.

section 10(c)(4). Specifically, the agencies are proposing to amend section 172(d) to clarify that the supplementary leverage ratio disclosure requirements described in section 172 apply without regard to whether the banking organization has completed the parallel run process. Under this proposal, any banking organization that becomes an advanced approaches banking organization pursuant to section 100(b)(1) before January 1, 2015, must publicly disclose its supplementary leverage ratio and the components thereof (that is, tier 1 capital and total leverage exposure) quarterly, beginning with the first quarter in 2015. A banking organizations that becomes an advanced approaches banking organization pursuant to section 100(b)(1) on or after January 1, 2015, must publicly disclose its supplementary leverage ratio and components thereof, beginning with the calendar quarter immediately following the calendar quarter in which the banking organization becomes an advanced approaches banking organization. For example, a banking organization that becomes subject to the advanced approaches because it has \$250 billion or more in consolidated total assets as of year-end 2015 pursuant to section 100(b)(1)(i) would begin disclosing its supplementary leverage ratio as of March 31, 2016.

In addition, the agencies are proposing to revise section 173 to clarify that a top-tier¹⁸ advanced approaches banking organization, regardless of its parallel run

¹⁸ Disclosure requirements in this section apply only to banking organizations that are not a consolidated subsidiary of a BHC, covered SLHC, or depository institution that is subject to these disclosure requirements or a subsidiary of a non-U.S. banking organization that is subject to comparable public disclosure requirements in its home jurisdiction.

status, is required to publicly disclose Table 13 for twelve consecutive quarters or a shorter period, as applicable, beginning on January 1, 2015. For example, for a banking organization that becomes subject to the supplementary leverage ratio disclosure requirements on January 1, 2015, reporting for the first quarter of 2015 would include data for one quarter, reporting for the second quarter of 2015 would include data for two quarters, and reporting for the fourth quarter of 2017 would include data for 12 quarters.

Exposure at default adjustment for recognized credit valuation adjustment (CVA)

Under subpart E of the regulatory capital framework, an advanced approaches banking organization that has received supervisory approval to calculate exposure at default (EAD) for derivative contracts using the internal models methodology (IMM) is permitted to reduce effective expected positive exposure (effective EPE) by the CVA recognized on the advanced approaches banking organization's balance sheet to reflect the fair value adjustment for counterparty credit risk in the valuation of a group of over-the-counter (OTC) derivative transactions in a netting set. The recognized CVA on the OTC derivative netting set deducted from effective EPE must not include any adjustments made by the advanced approaches banking organization to common equity tier 1 capital attributable to changes in the fair value of the banking organization's liabilities that are due to changes in its own credit risk since the inception of the derivative transaction with the counterparty. Similarly, the

agencies are proposing to allow advanced approaches banking organizations to reduce the EAD for OTC derivative contracts calculated according to the current exposure methodology in section 132(c) for the purpose of calculating advanced approaches total risk-weighted assets. The agencies note that in determining the fair value of a derivative on a banking organization's balance sheet, the recognized CVA on the netting set of OTC derivative contracts is intended to reflect the credit quality of the counterparty.

As noted in the preamble to the regulatory capital framework, the CVA capital charge in section 132(e) addresses fair value losses resulting from the deterioration of a counterparty's credit quality short of default. The proposal to permit advanced approaches banking organizations to reduce EAD by the recognized CVA on an OTC derivative netting set would prevent the double counting of the counterparty credit risk, which is already included in advanced approaches total risk-weighted assets through the CVA capital charge. Consistent with the Basel Committee's Basel III capital standards and the treatment of recognized CVA in the calculation of EAD for OTC derivatives according to the IMM, the agencies are proposing to amend section 132(c)(1) to permit an advanced approaches banking organization to reduce the EAD calculated according to the current exposure methodology by the recognized CVA on the OTC derivative netting set. The agencies note that, for the purpose of calculating standardized total risk-weighted assets, advanced approaches banking

organizations would not be permitted to reduce the EAD calculated according to the current exposure methodology because the standardized total risk-weighted assets calculation does not include the CVA capital charge calculated in section 132(e).

Margin period of risk in the internal models methodology (IMM)

Section 132(d)(5)(iii)(B) of the regulatory capital framework includes upward adjustments to the margin period of risk in the IMM for large netting sets, netting sets involving illiquid collateral or OTC derivatives that cannot easily be replaced, or netting sets with two or more margin disputes with the counterparty over the previous two quarters that last for a certain length of time. The regulatory capital framework inadvertently required an upward adjustment to the margin period of risk for cleared transactions based solely on the fact that they are part of a large netting set. The agencies are therefore proposing to amend this provision to clarify that cleared transactions that are part of a netting set subject to a collateral agreement that exceeds 5,000 trades at any time during the previous quarter are not subject to the twenty business day margin-period-of-risk requirement unless the netting set contains illiquid collateral, OTC derivatives that cannot easily be replaced, or the banking organization had two or more margin disputes with the counterparty over the previous two quarters that last for a certain length of time. As noted in the preamble to the regulatory capital framework, the 5,000 trade threshold is one indicator that a set of transactions may require a

lengthy period to close out in the event of a default of a counterparty. The agencies believe that unlike a large netting set of over-the-counter derivatives, a large netting set of cleared transactions would not require a lengthy period to close out in the event of a default of the CCP. In addition, the proposed amendment would conform the provision to the similar provision in section 37 of subpart D. However, for any netting set that involves illiquid collateral or OTC derivatives that cannot easily be replaced, or that has two or more margin disputes within a netting set over the previous two quarters that last for a certain length of time, the margin period of risk would require adjustments, as specified under section 132(d)(5)(iii)(B), regardless of whether the netting set consists of cleared transactions.

Qualification requirements and mechanics for calculating risk-weighted assets of wholesale and retail exposures under the advanced approaches

In February, 2014, the OCC and Board granted permission to a number of banking organizations to begin calculating their risk-based capital requirements under the advanced approaches.¹⁹ During the parallel run evaluation process, the agencies concluded that several areas of the advanced approaches rule should be revised to (1) clarify the qualification requirements and mechanics for calculating risk-weighted assets under the advanced approaches rule and (2) promote

¹⁹ Board Press Release <http://www.federalreserve.gov/newsevents/press/bcreg/20140221a.htm>; OCC Press release <http://www.occ.gov/news-issuances/news-releases/2014/nr-ia-2014-21.html>.

international consistency by more clearly aligning the U.S. regulations with international standards for use of the advanced approaches rule.

Sections 122 and 131 of the regulatory capital framework set forth the qualification requirements for the internal ratings-based approach (IRB) for advanced approaches banking organizations and describe the mechanics for calculating risk-weighted assets for wholesale and retail exposures under the advanced approaches. When the agencies initially adopted the advanced approaches rule in the 2007 rule, they viewed certain elements of the international Basel framework as being more akin to supervisory guidance, and therefore incorporated these elements into the supervisory review process rather than the advanced approaches rule. However, the agencies believe elements of sections 122 and 131 of the regulatory capital framework should be clarified to ensure that advanced approaches banking organizations appropriately: (i) obtain and consider all relevant and material information to estimate probability of default (PD), loss given default (LGD), and EAD; (ii) quantify risk parameters for wholesale and retail exposures; and (iii) establish internal requirements for collateral and risk management processes.

Accordingly, the agencies are proposing language to add specificity and enhance transparency regarding the qualification process for the IRB approach, as well as the mechanics used to calculate total wholesale and retail risk-weighted assets. More specifically, the NPR would amend sections 122 and 131 of the

regulatory capital framework to clarify requirements associated with: (i) the frequency for reviewing risk rating systems, (ii) the independence of the systems' development, design, and implementation, (iii) time horizons for default and loss data when estimating risk parameters, (iv) changes in banking organizations' lending, payment processing, and account monitoring practices, (v) the use of all relevant available data for assigning risk ratings, and (vi) the need for internal requirements for collateral management and risk management processes. These modifications are consistent with the current overarching principles in sections 122 and 131 of the regulatory capital framework that advanced approaches banking organizations must have an internal risk rating and segmentation system that accurately and reliably differentiates among degrees of credit risk for wholesale and retail exposures, as well as a comprehensive risk-parameter quantification process that produces accurate, timely, and reliable risk-parameter estimates. The agencies emphasize that the proposed revisions are intended to clarify, but not change, existing requirements. In fact, many of these clarifications are already included in agency guidance or examination materials. Therefore, because they have demonstrated that they comply with the existing requirements, the agencies would expect that advanced approaches banking organizations that have already exited parallel run have demonstrated that they would meet the proposed requirements.

Fair value of liabilities

Section 22 of the regulatory capital framework requires a banking organization to adjust its common equity tier 1 capital for changes in the fair value of liabilities due to changes in the banking organization's own credit risk. The adjustment is made by deducting from common equity tier 1 capital any net gain and adding to common equity tier 1 capital any net loss to offset the capital effect of the changes in fair value of liabilities due to changes in the banking organization's own credit risk.²⁰ Additionally, the regulatory capital framework requires advanced approaches banking organizations to deduct the credit spread premium over the risk-free rate for derivatives that are liabilities.

The agencies recognize that the regulatory capital framework is unclear as to whether the deduction of the credit spread premium for advanced approaches banking organizations is in addition to the adjustment for net gains or losses associated with changes in the value of liabilities attributed to changes in the banking organization's own credit risk. Therefore, the agencies are clarifying that for derivative liabilities, an advanced approaches banking organization would make the deduction of the credit spread premium over the risk-free rate as the adjustment for changes in the fair value of those derivative liabilities due to changes in the banking organization's own credit risk.

Technical corrections

²⁰ 12 CFR 3.22(b)(1)(iii) (OCC), 12 CFR 217.22(b)(1)(iii) (Board), and 12 CFR 324.22(b)(1)(iii) (FDIC).

In addition to the revisions discussed above, the proposed rule would also make certain technical corrections. Most of the proposed corrections to these technical errors are self-explanatory and, therefore, do not warrant specific discussion in this preamble. In addition, there are several reference errors that the agencies propose to correct in an effort to better clarify the rule requirements. For example, the proposed rule would correct the following internal cross-references in the regulatory capital framework.

- In section 131(e)(3)(vi), amendments to reference section 22(d) and not section 22(a)(7);
- In Table 1 of section 132, amendments to the reference in the column heading to state that “Non-sovereign issuers risk weight under this section (in percent)” and “Sovereign issuers risk weight under this section (in percent)” actually are found in section 32.
- In section 132(d)(7)(iv)(B), amendments to reference section 132(b)(2) and not section 131(b)(2);
- In section 132(d)(9)(ii), amendments to reference section 132(e)(6) and not section 132(e)(3);
- In section 133(b)(3)(i)(B), amendments to reference section 133(b)(3)(i)(A) and not section 132(b)(3)(i)(A); and
- In section 136(e)(2)(i) and 136(e)(2)(ii), amendments to reference section 136(e)(1) and (e)(2) and not section 135(e)(1) and (e)(2).

III. Regulatory Analyses

A. Paperwork Reduction Act (PRA)

In accordance with the requirements of the Paperwork Reduction Act of 1995 (44 U.S.C. § 3501-3521) (PRA), the agencies may not conduct or sponsor, and a respondent is not required to respond to, an information collection unless it displays a currently valid Office of Management and Budget (OMB) control number. The agencies reviewed the proposed rule and determined that it would not introduce any new collection of information pursuant to the PRA.

B. Regulatory Flexibility Act Analysis

OCC: The Regulatory Flexibility Act, 5 U.S.C. 601 *et seq.* (RFA), requires an agency, in connection with a proposed rule, to prepare an Initial Regulatory Flexibility Analysis describing the impact of the proposed rule on small entities (defined by the Small Business Administration for purposes of the RFA to include banking entities with total assets of \$550 million or less) or to certify that the proposed rule would not have a significant economic impact on a substantial number of small entities.

Using the SBA's size standards, as of December 31, 2013, the OCC supervised 1,231 small entities.²¹

²¹ The OCC calculated the number of small entities using the SBA's size thresholds for commercial banks and savings institutions, and trust companies, which are \$550 million and \$38.5 million, respectively. Consistent with the General Principles of Affiliation, 13 CFR 121.103(a), the OCC counted the assets of affiliated financial institutions when determining whether to classify a national bank or Federal savings association as a small entity. The OCC used December 31, 2013, to determine size because a "financial institution's assets are determined by averaging the assets reported on its four quarterly financial statements

As described in the **Supplementary Information** section of the preamble, the proposed rule would apply only to advanced approaches banking organizations. Advanced approaches banking organization is defined to include a national bank or Federal savings association that has, or is a subsidiary of, a bank holding company or savings and loan holding company that has total consolidated assets of \$250 billion or more, total consolidated on-balance sheet foreign exposure of \$10 billion or more, or that has elected to use the advanced approaches framework. After considering the SBA's size standards and General Principles of Affiliation to identify small entities, the OCC determined that no small national banks or Federal savings associations are advanced approaches banking organizations. Because the proposed rule would apply only to advanced approaches banking organizations, it would not impact any OCC-supervised small entities. Therefore, the OCC certifies that the proposed rule would not have a significant economic impact on a substantial number of OCC-supervised small entities.

FDIC: The Regulatory Flexibility Act, 5 U.S.C. 601 et seq. (RFA), requires an agency, in connection with a notice of proposed rulemaking, to prepare an Initial Regulatory Flexibility Act analysis describing the impact of the proposed rule on small entities (defined by the Small Business Administration for purposes of the RFA to include banking entities with total assets of \$550 million or less) or

for the preceding year.” See footnote 8 of the U.S. Small Business Administration’s *Table of Size Standards*.

to certify that the proposed rule will not have a significant economic impact on a substantial number of small entities.

Using the SBA's size standards, as of June 30, 2014, the FDIC supervised 3,573 small entities. As described in the **Supplementary Information** section of the preamble, however, the proposed rule would apply only to advanced approaches banking organizations. Advanced approaches banking organization is defined to include a state nonmember bank or a state savings association that has, or is a subsidiary of, a bank holding company or savings and loan holding company that has total consolidated assets of \$250 billion or more, total consolidated on-balance sheet foreign exposure of \$10 billion or more, or that has elected to use the advanced approaches framework. As of June 30, 2014, based on a \$550 million threshold, 2 (out of 3,267) small state nonmember banks and no (out of 306) small state savings associations were under the advanced approaches framework. Therefore, the FDIC does not believe that the proposed rule will result in a significant economic impact on a substantial number of small entities under its supervisory jurisdiction.

The FDIC certifies that the proposed rule would not have a significant economic impact on a substantial number of small FDIC-supervised institutions.

Board: The Board is providing an initial regulatory flexibility analysis with respect to this proposed rule. As discussed above, this proposed rule would clarify, correct, and update aspects of the agencies' regulatory capital framework applicable to banking organizations that are subject to the advanced approaches.

The proposed revisions are largely driven by observations made by the agencies during the parallel-run review process of advanced approaches banking organizations as well as a recent assessment of the regulatory capital framework.

Under regulations issued by the Small Business Administration, a small entity includes a depository institution, bank holding company, or savings and loan holding company with total assets of \$550 million or less (a small banking organization).²² As of June 30, 2014, there were approximately 657 small state member banks, 3,719 small bank holding companies, and 254 small savings and loan holding companies.

The proposed rule would apply only to advanced approaches banking organizations, which, generally, are banking organizations with total consolidated assets of \$250 billion or more, that have total consolidated on-balance sheet foreign exposure of \$10 billion or more, are a subsidiary of an advanced approaches depository institution, or that elect to use the advanced approaches framework. Currently, no small top-tier bank holding company, top-tier savings and loan holding company, or state member bank is an advanced approaches banking organization, so there would be no additional projected compliance requirements imposed on small bank holding companies, savings and loan holding companies, or state member banks. The Board expects that any small bank holding company, savings and loan holding company, or state member bank that

²² See 13 CFR 121.201. Effective July 14, 2014, the Small Business Administration revised the size standards for banking organizations to \$550 million in assets from \$500 million in assets. 79 FR 33647 (June 12, 2014).

would be covered by this proposed rule would rely on its parent banking organization for compliance and would not bear additional costs.

The Board is aware of no other federal rules that duplicate, overlap, or conflict with the proposed rule. The Board believes that the proposed rule will not have a significant economic impact on small banking organizations supervised by the Board and therefore believes that there are no significant alternatives to the proposed rule that would reduce the economic impact on small banking organizations supervised by the Board.

The Board welcomes comment on all aspects of its analysis. A final regulatory flexibility analysis will be conducted after consideration of comments received during the public comment period.

C. OCC Unfunded Mandates Reform Act of 1995 Determination

The OCC has analyzed the notice of proposed rulemaking under the factors set forth in the Unfunded Mandates Reform Act of 1995 (UMRA) (2 U.S.C. 1532). Under this analysis, the OCC considered whether the proposed rule includes a Federal mandate that may result in the expenditure by State, local, and Tribal governments, in the aggregate, or by the private sector, of \$100 million or more in any one year (adjusted annually for inflation).

The proposed rule includes clarifications, corrections, and updates for certain aspects of the agencies' regulatory capital rules applicable to national

banks and Federal savings associations subject to the OCC's advanced approaches risk-based capital rule.

Because the proposed rule is designed to clarify, correct, and update existing rules, and does not introduce any new requirements, the OCC has determined that it would not result in expenditures by State, local, and Tribal governments, or by the private sector, of \$100 million or more. Accordingly, the OCC has not prepared a written statement to accompany its proposed rule.

D. Plain Language

Section 722 of the Gramm-Leach-Bliley Act requires the Federal banking agencies to use plain language in all proposed and final rules published after January 1, 2000. The agencies have sought to present the proposed rule in a simple and straightforward manner, and invite comment on the use of plain language. For example:

- Have the agencies organized the material to suit your needs? If not, how could they present the proposed rule more clearly?

- Are the requirements in the proposed rule clearly stated? If not, how could the proposed rule be more clearly stated?

- Do the regulations contain technical language or jargon that is not clear? If so, which language requires clarification?

- Would a different format (grouping and order of sections, use of headings, paragraphing) make the regulation easier to understand? If so, what changes would achieve that?

- Is this section format adequate? If not, which of the sections should be changed and how?

- What other changes can the agencies incorporate to make the regulation easier to understand?

List of Subjects

12 CFR Part 3

Administrative practice and procedure, Capital, National banks, Reporting and recordkeeping requirements, Risk.

12 CFR Part 217

Administrative practice and procedure, Banks, Banking, Capital, Federal Reserve System, Holding companies, Reporting and recordkeeping requirements, Securities.

12 CFR Part 324

Administrative practice and procedure, Banks, banking, Capital Adequacy, Reporting and recordkeeping requirements, Savings associations, State non-member banks.

DEPARTMENT OF THE TREASURY

Office of the Comptroller of the Currency

12 CFR Chapter I

Authority and Issuance

For the reasons set forth in the common preamble and under the authority of 12 U.S.C. 93a, 1462, 1462a, 1463, 1464, 3907, 3909, 1831o, and 5412(b)(2)(B), the Office of the Comptroller of the Currency proposes to amend part 3 of chapter I of title 12, Code of Federal Regulations as follows:

Part 3—CAPITAL ADEQUACY STANDARDS

- 1. The authority citation for part 3 continues to read as follows:

Authority: 12 U.S.C. 93a, 161, 1462, 1462a, 1463, 1464, 1818, 1828(n), 1828 note, 1831n note, 1835, 3907, 3909, and 5412(b)(2)(B).

- 2. Section 3.2 is amended by revising the definition of “Residential mortgage exposure” to read as follows:

§ 3.2 Definitions.

* * * * *

Residential mortgage exposure means an exposure (other than a securitization exposure, equity exposure, statutory multifamily mortgage, or presold construction loan) that is:

- (1)(i) An exposure that is primarily secured by a first or subsequent lien on one-to-four family residential property; or
- (ii) An exposure with an original and outstanding amount of \$1 million or less that is primarily secured by a first or subsequent lien on residential property that is not one-to-four family; and

(2) For purposes of calculating capital requirements under subpart E of this part, managed as part of a segment of exposures with homogeneous risk characteristics and not on an individual-exposure basis.

* * * * *

■ 3. Section 3.10 is amended by revising paragraph (c) introductory text to read as follows:

3.10 Minimum capital requirements.

* * * * *

(c) Advanced approaches capital ratio calculations. An advanced approaches national bank or Federal savings association that has completed the parallel run process and received notification from the OCC pursuant to § 3.121(d) must determine its regulatory capital ratios as described in paragraphs (c)(1) through (3) of this section. An advanced approaches national bank or Federal savings association must determine its supplementary leverage ratio in accordance with paragraph (c)(4) of this section, beginning with the calendar quarter immediately following the quarter in which the national bank or Federal savings association meets any of the criteria in §3.100(b)(1).

* * * * *

- 4. Section 3.22 is amended by revising paragraph (b)(1)(iii) to read as follows:

§ 3.22 Regulatory capital adjustments and deductions.

* * * * *

(b) * * *

(1) * * *

(iii) A national bank or Federal savings association must deduct any net gain and add any net loss related to changes in the fair value of liabilities that are due to changes in the national bank's or Federal savings association's own credit risk. An advanced approaches national bank or Federal savings association must deduct the difference between its credit spread premium and the risk-free rate for derivatives that are liabilities as part of this adjustment.

* * * * *

- 5. Section 3.100 is amended by revising paragraph (b)(1)(ii) to read as follows:

§ 3.100 Purpose, applicability, and principle of conservatism.

* * * *

(b) * * *

(1) * * *

(ii) Has consolidated total on-balance sheet foreign exposure on its most recent year-end Call Report equal to \$10 billion or more (where total on-balance sheet foreign exposure equals total foreign countries cross-border claims on an ultimate-risk basis, plus total foreign countries claims on local residents on an ultimate-risk basis, plus total foreign countries fair value of foreign exchange and derivative products), calculated in accordance with the Federal Financial Institutions Examination Council (FFIEC) 009 Country Exposure Report;

* * * *

- 6. Section 3.122 is amended by:
 - a. Revising paragraphs (a)(3) and (b)(1);
 - b. Adding paragraph (b)(2)(iii);
 - c. Revising paragraphs (b)(3) and (5) and (c)(1), (2), (5), and (6);
 - d. Redesignating paragraphs (c)(9) and (10) as paragraphs (c)(10) and (11), revising them, and adding a new paragraph (c)(9); and
 - e. Revising paragraph (i)(5).

The revisions and additions read as follows:

§3.122 Qualification requirements.

(a) * * *

(3) Each national bank or Federal savings association must have an appropriate infrastructure with risk measurement and management processes that meet the qualification requirements of this section and are appropriate given the national bank's or Federal savings association's size and level of complexity. Regardless of whether the systems and models that generate the risk parameters necessary for calculating a national bank's or Federal savings association's risk-based capital requirements are located at any affiliate of the national bank or Federal savings association, the national bank or Federal savings association itself must ensure that the risk parameters and reference data used to determine its risk-based capital requirements are representative of long run experience with respect to its own credit risk and operational risk exposures.

(b) Risk rating and segmentation systems for wholesale and retail exposures.

(1)(i) A national bank or Federal savings association must have an internal risk rating and segmentation system that accurately, reliably, and meaningfully differentiates among degrees of credit risk for the national bank's or Federal savings association's wholesale and retail exposures. When assigning an internal risk rating, a national bank or Federal savings association may consider a third-party assessment of credit risk, provided that the national bank's or Federal savings association's internal risk rating assignment does not rely solely on the external assessment.

(ii) If a national bank or Federal savings association uses multiple rating or segmentation systems, the national bank's or Federal savings association's rationale for assigning an obligor or exposure to a particular system must be documented and applied in a manner that best reflects the obligor's or exposure's level of risk. A national bank or Federal savings association must not inappropriately allocate obligors or exposures across systems to minimize regulatory capital requirements.

(iii) In assigning ratings to wholesale obligors and exposures, including loss severity ratings grades to wholesale exposures, and assigning retail exposures to retail segments, a national bank or Federal savings association must use all relevant and material information and ensure that the information is current.

(iv) When assigning an obligor to a PD rating or retail exposure to a PD segment, a national bank or Federal savings association must assess the obligor or retail borrower's

ability and willingness to contractually perform, taking a conservative view of projected information.

(2) * * *

(iii) A national bank or Federal savings association must have an effective process to obtain and update in a timely manner relevant and material information on obligor and exposure characteristics that affect PD, LGD and EAD.

(3) For retail exposures:

(i) A national bank or Federal savings association must have an internal system that groups retail exposures into the appropriate retail exposure subcategory and groups the retail exposures in each retail exposure subcategory into separate segments with homogeneous risk characteristics that provide a meaningful differentiation of risk. The national bank's or Federal savings association's system must identify and group in separate segments by subcategories exposures identified in § 3.131(c)(2)(ii) and (iii).

(ii) A national bank or Federal savings association must have an internal system that captures all relevant exposure risk characteristics, including borrower credit score, product and collateral types, as well as exposure delinquencies, and must consider cross-collateral provisions, where present.

(iii) The national bank or Federal savings association must review and, if appropriate, update assignments of individual retail exposures to segments and the loss characteristics and delinquency status of each identified risk segment. These reviews

must occur whenever the national bank or Federal savings association receives new material information, but generally no less frequently than quarterly, and, in all cases, at least annually.

* * * * *

(5) The national bank's or Federal savings association's internal risk rating system for wholesale exposures must provide for the review and update (as appropriate) of each obligor rating and (if applicable) each loss severity rating whenever the national bank or Federal savings association obtains relevant and material information on the obligor or exposure that affect PD, LGD and EAD, but no less frequently than annually.

(c) Quantification of risk parameters for wholesale and retail exposures. (1) The national bank or Federal savings association must have a comprehensive risk parameter quantification process that produces accurate, timely, and reliable estimates of the risk parameters on a consistent basis for the national bank's or Federal savings association's wholesale and retail exposures.

(2) A national bank's or Federal savings association's estimates of PD, LGD, and EAD must incorporate all relevant, material, and available data that is reflective of the national bank's or Federal savings association's actual wholesale and retail exposures and of sufficient quality to support the determination of risk-based capital requirements for the exposures. In particular, the population of exposures in the data used for estimation purposes, and lending standards in use when the data were generated, and other relevant characteristics, should closely match or be comparable to the national bank's or Federal

savings association's exposures and standards. In addition, a national bank or Federal savings association must:

(i) Demonstrate that its estimates are representative of long run experience, including periods of economic downturn conditions, whether internal or external data are used;

(ii) Take into account any changes in lending practice or the process for pursuing recoveries over the observation period;

(iii) Promptly reflect technical advances, new data, and other information as they become available;

(iv) Demonstrate that the data used to estimate risk parameters support the accuracy and robustness of those estimates; and

(v) Demonstrate that its estimation technique performs well in out-of-sample tests whenever possible.

* * * * *

(5) The national bank or Federal savings association must be able to demonstrate which variables have been found to be statistically significant with regard to EAD. The national bank's or Federal savings association's EAD estimates must reflect its specific policies and strategies with regard to account management, including account monitoring and payment processing, and its ability and willingness to prevent further drawdowns in circumstances short of payment default. The national bank or Federal savings association

must have adequate systems and procedures in place to monitor current outstanding amounts against committed lines, and changes in outstanding amounts per obligor and obligor rating grade and per retail segment. The national bank or Federal savings association must be able to monitor outstanding amounts on a daily basis.

(6) At a minimum, PD estimates for wholesale obligors and retail segments must be based on at least five years of default data. LGD estimates for wholesale exposures must be based on at least seven years of loss severity data, and LGD estimates for retail segments must be based on at least five years of loss severity data. EAD estimates for wholesale exposures must be based on at least seven years of exposure amount data, and EAD estimates for retail segments must be based on at least five years of exposure amount data. If the national bank or Federal savings association has relevant and material reference data that span a longer period of time than the minimum time periods specified above, the national bank or Federal savings association must incorporate such data in its estimates, provided that it does not place undue weight on periods of favorable or benign economic conditions relative to periods of economic downturn conditions.

* * * * *

(9) If a national bank or Federal savings association uses internal data obtained prior to becoming subject to this subpart E or external data to arrive at PD, LGD, or EAD estimates, the national bank or Federal savings association must demonstrate to the OCC that the national bank or Federal savings association has made appropriate adjustments if necessary to be consistent with the definition of default in § 3.101. Internal data obtained

after the national bank or Federal savings association becomes subject to this subpart E must be consistent with the definition of default in § 3.101.

(10) The national bank or Federal savings association must review and update (as appropriate) its risk parameters and its risk parameter quantification process at least annually.

(11) The national bank or Federal savings association must, at least annually, conduct a comprehensive review and analysis of reference data to the national bank's or Federal savings association's exposures, quality of reference data to support PD, LGD, and EAD estimates, and consistency of reference data to the definition of default in §3.101.

* * * * *

(i) * * *

(5) The national bank or Federal savings association must have an internal audit function or equivalent function that is independent of business-line management that at least annually:

(i) Reviews the national bank's or Federal savings association's advanced systems and associated operations, including the operations of its credit function and estimations of PD, LGD, and EAD;

(ii) Assesses the effectiveness of the controls supporting the national bank's or Federal savings association's advanced systems; and

(iii) Documents and reports its findings to the national bank's or Federal savings association's board of directors (or a committee thereof).

* * * * *

■ 7. Section 3.131 is amended by:

- a. Revising paragraphs (d)(5)(ii) and (iii); and
- b. In paragraph (e)(3)(vi), removing “§ 3.22(a)(7)” and adding “§ 3.22(d)” in its place.

The revisions read as follows:

§3.131 Mechanics for calculating total wholesale and retail risk-weighted assets.

* * * * *

(d) * * *

(5) * * *

(ii) A national bank or Federal savings association may take into account the risk reducing effects of guarantees and credit derivatives in support of retail exposures in a segment when quantifying the PD and LGD of the segment. In doing so, a national bank or Federal savings association must consider all relevant available information.

(iii) Except as provided in paragraph (d)(6) of this section, a national bank or Federal savings association may take into account the risk reducing effects of collateral in

support of a wholesale exposure when quantifying the LGD of the exposure, and may take into account the risk reducing effects of collateral in support of retail exposures when quantifying the PD and LGD of the segment. In order to do so, a national bank or Federal savings association must have established internal requirements for collateral management, legal certainty, and risk management processes.

* * * * *

■ 8. Section 3.132 is amended by:

- a. In Table 1 to § 3.132, removing “this section” and adding “§ 3.32” in its place, wherever it appears;
- b. Revising paragraphs (c)(1) and (d)(5)(iii)(B);
- c. In paragraph (d)(7)(iv)(B), removing “§ 3.131(b)(2)” and adding “§ 3.132(b)(2)” in its place; and
- d. In paragraph (d)(9)(ii), removing “paragraph (e)(3)” and adding “paragraph (e)(6)” in its place.

The revisions read as follows:

§ 3.132 Counterparty credit risk of repo-style transactions, eligible margin loans, and OTC derivative contracts.

* * * * *

(c) EAD for OTC derivative contracts — (1) OTC derivative contracts not subject to a qualifying master netting agreement. A national bank or Federal savings association must determine the EAD for an OTC derivative contract that is not subject to a qualifying master netting agreement using the current exposure methodology in paragraph (c)(5) of this section or using the internal models methodology described in paragraph (d) of this section. A national bank or Federal savings association may reduce the EAD calculated according to paragraphs (c)(5) or (d) of this section by the credit valuation adjustment that the national bank or Federal savings association has recognized in its balance sheet valuation of any OTC derivative contracts in the netting set. For purposes of this paragraph (c), the credit valuation adjustment does not include any adjustments to common equity tier 1 capital attributable to changes in the fair value of the national bank's or Federal savings association's liabilities that are due to changes in its own credit risk since the inception of the transaction with the counterparty.

* * * *

(d) * * *

(5) * * *

(iii) * * *

(B) Twenty business days if the number of trades in a netting set exceeds 5,000 at any time during the previous quarter (except if the national bank or Federal savings

association is calculating EAD for a cleared transaction under § 3.133) or contains one or more trades involving illiquid collateral or any derivative contract that cannot be easily replaced. If over the two previous quarters more than two margin disputes on a netting set have occurred that lasted more than the margin period of risk, then the national bank or Federal savings association must use a margin period of risk for that netting set that is at least two times the minimum margin period of risk for that netting set. If the periodicity of the receipt of collateral is N-days, the minimum margin period of risk is the minimum margin period of risk under this paragraph (d) plus N minus 1. This period should be extended to cover any impediments to prompt re-hedging of any market risk.

* * * * *

■ 9. Section 3.133 is amended by:

- a. In paragraph (b)(3)(i)(B) removing “§ 3.132(b)(3)(i)(A)” and adding “§ 3.133(b)(3)(i)(A)” in its place;
- b. In paragraph (b)(4)(ii) removing “§ 3.131” and adding “subparts E or F of this part, as applicable” in its place;
- c. Adding paragraph (c)(3)(iii); and
- d. In paragraph (c)(4)(ii) removing “§ 3.131” and adding “subparts E or F of this part, as applicable” in its place.

The addition reads as follows:

§ 3.133 Cleared transactions.

* * * * *

(c) * * *

(3) * * *

(iii) Notwithstanding paragraphs (c)(3)(i) and (ii) of this section, a clearing member national bank or Federal savings association may apply a risk weight of 0 percent to the trade exposure amount for a cleared transaction with a CCP where the clearing member national bank or Federal savings association is acting as a financial intermediary on behalf of a clearing member client, the transaction offsets another transaction that satisfies the requirements set forth in § 3.3(a), and the clearing member national bank or Federal savings association is not obligated to reimburse the clearing member client in the event of the CCP default.

* * * * *

§ 3.136 [Amended]

■ 10. Section 3.136 is amended by:

- a. In paragraph (e)(2)(i), removing “§ 3.135(e)(1) and (e)(2)” and adding “§ 3.136(e)(1) and (2)” in its place; and
- b. In paragraph (e)(2)(ii), removing “§§ 3.135(e)(1) and (e)(2)” and adding “§ 3.136(e)(1) and (2)” in its place.

■ 11. Section 3.172 is amended by revising paragraph (d), as added at 79 FR 57743, September 26, 2014, effective January 1, 2015, to read as follows:

§ 3.172 Disclosure requirements.

* * * * *

(d)(1) A national bank or Federal savings association that meets any of the criteria in § 3.100(b)(1) before January 1, 2015, must publicly disclose each quarter its supplementary leverage ratio and the components thereof (that is, tier 1 capital and total leverage exposure) as calculated under subpart B of this part, beginning with the first quarter in 2015. This disclosure requirement applies without regard to whether the national bank or Federal savings association has completed the parallel run process and received notification from the OCC pursuant to § 3.121(d).

(2) A national bank or Federal savings association that meets any of the criteria in § 3.100(b)(1) on or after January 1, 2015, must publicly disclose each quarter its

supplementary leverage ratio and the components thereof (that is, tier 1 capital and total leverage exposure) as calculated under subpart B of this part beginning with the calendar quarter immediately following the quarter in which the national bank or Federal savings association becomes an advanced approaches national bank or Federal savings association. This disclosure requirement applies without regard to whether the national bank or Federal savings association has completed the parallel run process and has received notification from the OCC pursuant to § 3.121(d).

- 12. Section 3.173 is amended by:
 - a. Redesignating paragraph (a) introductory text, as revised at 79 FR 57743, September 26, 2014, effective January 1, 2015, as paragraph (a)(1) and revising it;
 - b. Adding paragraphs (a)(2) and (3);
 - c. Revising the entry for (a)(1) in Table 6 to § 3.173; and
 - d. Revising the entry for (i)(2) in Table 9 to § 3.173.

The revisions and additions read as follows:

§3.173 Disclosures by certain advanced approaches national banks or Federal savings associations.

(a)(1) An advanced approaches national bank or Federal savings association described in § 3.172(b) must make the disclosures described in Tables 1 through 12 to § 3.173.

(2) An advanced approaches national bank or Federal savings association that is required to publicly disclose its supplementary leverage ratio pursuant to § 3.172(d) must make the disclosures required under Table 13 to § 3.173, unless the national bank or Federal savings association is a consolidated subsidiary of a bank holding company, savings and loan holding company, or depository institution that is subject to these disclosures requirements or a subsidiary of a non-U.S. banking organization that is subject to comparable public disclosure requirements in its home jurisdiction.

(3) The disclosures described in Tables 1 through 12 to § 3.173 must be made publicly available for twelve consecutive quarters beginning on January 1, 2014, or a shorter period, as applicable, for the quarters after the national bank or Federal savings association has completed the parallel run process and received notification from the OCC pursuant to § 121(d) of subpart E of this part. The disclosures described in Table 13 to § 3.173 must be made publicly available for twelve consecutive quarters beginning on January 1, 2015, or a shorter period, as applicable, for the quarters after the national bank or Federal savings association becomes subject to the disclosure of the supplementary leverage ratio pursuant to § 3.172(d).

* * * * *

TABLE 6 TO § 3.173—CREDIT RISK: DISCLOSURES FOR PORTFOLIOS SUBJECT TO IRB
RISK-BASED CAPITAL FORMULA

Qualitative disclosures	(a)	* * *
		(1) Structure of internal rating systems and if the national bank or Federal savings association considers external ratings, the relation between internal and external ratings;
* *	* *	* * *

* * * * *

TABLE 9 To § 3.173—SECURITIZATION

* *	* *	* * *
Quantitative disclosures	* * *	
	(i)	* * *
		(2) Aggregate amount disclosed separately by type of underlying exposure in the pool of any: (A) After-tax gain-on-sale on a securitization that has been deducted from common equity tier 1 capital; and (B) Credit-enhancing interest-only strip that is assigned a 1,250 percent risk weight.
* *	* *	* * *

* * * *

Board of Governors of the Federal Reserve System

12 CFR Chapter II

Authority and Issuance

For the reasons set forth in the common preamble, part 217 of chapter II of title 12 of the Code of Federal Regulations is proposed to be amended as follows:

PART 217 – CAPITAL ADEQUACY OF BANK HOLDING COMPANIES, SAVINGS AND LOAN HOLDING COMPANIES, AND STATE MEMBER BANKS (REGULATION Q)

- 13. The authority citation for part 217 continues to read as follows:

Authority: 12 U.S.C. 248(a), 321-338a, 481-486, 1462a, 1467a, 1818, 1828, 1831n, 1831o, 1831p-l, 1831w, 1835, 1844(b), 1851, 3904, 3906-3909, 4808, 5365, 5368, 5371.

- 14. Section 217.2 is amended by revising the definition of “Residential mortgage exposure” to read as follows:

§ 217.2 Definitions.

* * * * *

Residential mortgage exposure means an exposure (other than a securitization exposure, equity exposure, statutory multifamily mortgage, or presold construction loan) that is:

(1)(i) An exposure that is primarily secured by a first or subsequent lien on one-to-four family residential property; or

(ii) An exposure with an original and outstanding amount of \$1 million or less that is primarily secured by a first or subsequent lien on residential property that is not one-to-four family; and

(2) For purposes of calculating capital requirements under subpart E of this part, managed as part of a segment of exposures with homogeneous risk characteristics and not on an individual-exposure basis.

* * * * *

- 15. Section 217.10 is amended by revising paragraph (c) introductory text to read as follows:

§ 217.10 Minimum capital requirements.

* * * * *

(c) Advanced approaches capital ratio calculations. An advanced approaches Board-regulated institution that has completed the parallel run process and received notification from the Board pursuant to § 217.121(d) must determine its regulatory capital ratios as described in paragraphs (c)(1) through (3) of this section. An advanced approaches Board-regulated institution must determine its supplementary leverage ratio in accordance with paragraph (c)(4) of this section, beginning with the calendar quarter immediately following the quarter in which the Board-regulated institution meets any of the criteria in § 217.100(b)(1).

* * * * *

- 16. Section 217.22 is amended by revising paragraph (b)(1)(iii) to read as follows:

§ 217.22 Regulatory capital adjustments and deductions.

* * * * *

(b) * * *

(1) * * *

(iii) A Board-regulated institution must deduct any net gain and add any net loss related to changes in the fair value of liabilities that are due to changes in the Board-regulated institution's own credit risk. An advanced approaches Board-regulated institution must deduct the difference between its credit spread premium and the risk-free rate for derivatives that are liabilities as part of this adjustment.

* * * * *

■ 17. Section 217.100 is amended by revising paragraph (b)(1)(ii)(B) to read as follows:

§ 217.100 Purpose, applicability, and principle of conservatism

* * * * *

(b) * * *

(1) * * *

(ii) * * *

(B) Has consolidated total on-balance sheet foreign exposure on its most recent year-end Call Report, for a state member bank, or FR Y-9C, for a bank holding company or

savings and loan holding company, as applicable, equal to \$10 billion or more (where total on-balance sheet foreign exposure equals total foreign countries cross-border claims on an ultimate-risk basis, plus total foreign countries claims on local residents on an ultimate-risk basis, plus total foreign countries fair value of foreign exchange and derivative products), calculated in accordance with the Federal Financial Institutions Examination Council (FFIEC) 009 Country Exposure Report;

* * * * *

■ 18. Section 217.122 is amended by:

- a. Revising paragraphs (a)(3) and (b)(1),;
- b. Adding paragraph (b)(2)(iii);
- c. Revising paragraphs (b)(3) and (5) and (c)(1), (2), (5), and (6);
- d. Redesignating paragraphs (c)(9) and (10) as paragraphs (c)(10) and (11), revising them, and, adding a new paragraph (c)(9); and
- e. Revising paragraph (i)(5).

The revisions and additions read as follows:

§217.122 Qualification requirements.

(a) * * *

(3) Each Board-regulated institution must have an appropriate infrastructure with risk measurement and management processes that meet the qualification requirements of this section and are appropriate given the Board-regulated institution's size and level of

complexity. Regardless of whether the systems and models that generate the risk parameters necessary for calculating a Board-regulated institution's risk-based capital requirements are located at any affiliate of the Board-regulated institution, the Board-regulated institution itself must ensure that the risk parameters and reference data used to determine its risk-based capital requirements are representative of long run experience with respect to its own credit risk and operational risk exposures.

(b) Risk rating and segmentation systems for wholesale and retail exposures.

(1)(i) A Board-regulated institution must have an internal risk rating and segmentation system that accurately, reliably, and meaningfully differentiates among degrees of credit risk for the Board-regulated institution's wholesale and retail exposures. When assigning an internal risk rating, a Board-regulated institution may consider a third-party assessment of credit risk, provided that the Board-regulated institution's internal risk rating assignment does not rely solely on the external assessment.

(ii) If a Board-regulated institution uses multiple rating or segmentation systems, the Board-regulated institution's rationale for assigning an obligor or exposure to a particular system must be documented and applied in a manner that best reflects the obligor or exposure's level of risk. A Board-regulated institution must not inappropriately allocate obligors across systems to minimize regulatory capital requirements.

(iii) In assigning ratings to wholesale obligors and exposures, including loss severity ratings grades to wholesale exposures, and assigning retail exposures to retail

segments, a Board-regulated institution must use all relevant and material information and ensure that the information is current.

(iv) When assigning an obligor to a PD rating or retail exposure to a PD segment, a Board-regulated institution must assess the obligor or retail borrower's ability and willingness to contractually perform, taking a conservative view of projected information.

(2) * * *

(iii) A Board-regulated institution must have an effective process to obtain and update in a timely manner relevant and material information on obligor and exposure characteristics that affect PD, LGD and EAD.

(3) For retail exposures:

(i) A Board-regulated institution must have an internal system that groups retail exposures into the appropriate retail exposure subcategory and groups the retail exposures in each retail exposure subcategory into separate segments with homogeneous risk characteristics that provide a meaningful differentiation of risk. The Board-regulated institution's system must identify and group in separate segments by subcategories exposures identified in § 217.131(c)(2)(ii) and (iii).

(ii) A Board-regulated institution must have an internal system that captures all relevant exposure risk characteristics, including borrower credit score, product and collateral types, as well as exposure delinquencies, and must consider cross-collateral provisions, where present.

(iii) The Board-regulated institution must review and, if appropriate, update assignments of individual retail exposures to segments and the loss characteristics and delinquency status of each identified risk segment. These reviews must occur whenever the Board-regulated institution receives new material information, but generally no less frequently than quarterly, and, in all cases, at least annually.

* * * * *

(5) The Board-regulated institution's internal risk rating system for wholesale exposures must provide for the review and update (as appropriate) of each obligor rating and (if applicable) each loss severity rating whenever the Board-regulated institution obtains relevant and material information on the obligor or exposure that affect PD, LGD and EAD, but no less frequently than annually.

(c) Quantification of risk parameters for wholesale and retail exposures. (1) The Board-regulated institution must have a comprehensive risk parameter quantification process that produces accurate, timely, and reliable estimates of the risk parameters on a consistent basis for the Board-regulated institution's wholesale and retail exposures.

(2) A Board-regulated institution's estimates of PD, LGD, and EAD must incorporate all relevant, material, and available data that is reflective of the Board-regulated institution's actual wholesale and retail exposures and of sufficient quality to support the determination of risk-based capital requirements for the exposures. In particular, the population of exposures in the data used for estimation purposes, and lending standards in use when the data were generated, and other relevant characteristics,

should closely match or be comparable to the Board-regulated institution's exposures and standards. In addition, a Board-regulated institution must:

(i) Demonstrate that its estimates are representative of long run experience, including periods of economic downturn conditions, whether internal or external data are used;

(ii) Take into account any changes in lending practice or the process for pursuing recoveries over the observation period;

(iii) Promptly reflect technical advances, new data, and other information as they become available;

(iv) Demonstrate that the data used to estimate risk parameters support the accuracy and robustness of those estimates; and

(v) Demonstrate that its estimation technique performs well in out-of-sample tests whenever possible.

* * * * *

(5) The Board-regulated institution must be able to demonstrate which variables have been found to be statistically significant with regard to EAD. The Board-regulated institution's EAD estimates must reflect its specific policies and strategies with regard to account management, including account monitoring and payment processing, and its ability and willingness to prevent further drawdowns in circumstances short of payment default. The Board-regulated institution must have adequate systems and procedures in

place to monitor current outstanding amounts against committed lines, and changes in outstanding amounts per obligor and obligor rating grade and per retail segment. The Board-regulated institution must be able to monitor outstanding amounts on a daily basis.

(6) At a minimum, PD estimates for wholesale obligors and retail segments must be based on at least five years of default data. LGD estimates for wholesale exposures must be based on at least seven years of loss severity data, and LGD estimates for retail segments must be based on at least five years of loss severity data. EAD estimates for wholesale exposures must be based on at least seven years of exposure amount data, and EAD estimates for retail segments must be based on at least five years of exposure amount data. If the Board-regulated institution has relevant and material reference data that span a longer period of time than the minimum time periods specified above, the Board-regulated institution must incorporate such data in its estimates, provided that it does not place undue weight on periods of favorable or benign economic conditions relative to periods of economic downturn conditions.

* * * * *

(9) If a Board-regulated institution uses internal data obtained prior to becoming subject to this subpart E or external data to arrive at PD, LGD, or EAD estimates, the Board-regulated institution must demonstrate to the Board that the Board-regulated institution has made appropriate adjustments if necessary to be consistent with the definition of default in § 217.101. Internal data obtained after the Board-regulated

institution becomes subject to this subpart E must be consistent with the definition of default in § 217.101.

(10) The Board-regulated institution must review and update (as appropriate) its risk parameters and its risk parameter quantification process at least annually.

(11) The Board-regulated institution must, at least annually, conduct a comprehensive review and analysis of reference data to the Board-regulated institution's exposures, quality of reference data to support PD, LGD, and EAD estimates, and consistency of reference data to the definition of default in § 217.101.

* * * * *

(i) * * *

(5) The Board-regulated institution must have an internal audit function or equivalent function that is independent of business-line management that at least annually:

(i) Reviews the Board-regulated institution's advanced systems and associated operations, including the operations of its credit function and estimations of PD, LGD, and EAD;

(ii) Assesses the effectiveness of the controls supporting the Board-regulated institution's advanced systems; and

(iii) Documents and reports its findings to the Board-regulated institution's board of directors (or a committee thereof).

* * * * *

■ 19. Section 217.131 is amended by:

■ a. Revising paragraphs (d)(5)(ii) and (iii); and

■ b. In paragraph (e)(3)(vi), removing “§ 217.22(a)(7)” and adding “§ 217.22(d)” in its place.

The revisions read as follows:

§217.131 Mechanics for calculating total wholesale and retail risk-weighted assets.

* * * * *

(d) * * *

(5) * * *

(ii) A national bank or Federal savings association may take into account the risk reducing effects of guarantees and credit derivatives in support of retail exposures in a segment when quantifying the PD and LGD of the segment. In doing so, a national bank or Federal savings association must consider all relevant available information.

(iii) Except as provided in paragraph (d)(6) of this section, a national bank or Federal savings association may take into account the risk reducing effects of collateral in

support of a wholesale exposure when quantifying the LGD of the exposure, and may take into account the risk reducing effects of collateral in support of retail exposures when quantifying the PD and LGD of the segment. In order to do so, a national bank or Federal savings association must have established internal requirements for collateral management, legal certainty, and risk management processes.

* * * * *

- 20. Section 217.132 is amended by:
 - a. In Table 1 to § 217.132, removing “this section” and adding “§ 217.32” in its place, wherever it appears;
 - b. Revising paragraphs (c)(1) and (d)(5)(iii)(B);
 - c. In paragraph (d)(7)(iv)(B), removing “§ 217.131(b)(2)” and adding “§ 217.132(b)(2)” in its place; and
 - d. In paragraph (d)(9)(ii), removing “paragraph (e)(3)” and adding “paragraph (e)(6)” in its place.

The revisions read as follows:

§ 217.132 Counterparty credit risk of repo-style transactions, eligible margin loans, and OTC derivative contracts.

* * * * *

(c) EAD for OTC derivative contracts — (1) OTC derivative contracts not subject to a qualifying master netting agreement. A Board-regulated institution must determine the EAD for an OTC derivative contract that is not subject to a qualifying master netting agreement using the current exposure methodology in paragraph (c)(5) of this section or using the internal models methodology described in paragraph (d) of this section. A Board-regulated institution may reduce the EAD calculated according to paragraphs (c)(5) or (d) of this section by the credit valuation adjustment that the Board-regulated institution has recognized in its balance sheet valuation of any OTC derivative contracts in the netting set. For purposes of this paragraph (c), the credit valuation adjustment does not include any adjustments to common equity tier 1 capital attributable to changes in the fair value of the Board-regulated institution's liabilities that are due to changes in its own credit risk since the inception of the transaction with the counterparty.

* * * *

(d) * * *

(5) * * *

(iii) * * *

(B) Twenty business days if the number of trades in a netting set exceeds 5,000 at any time during the previous quarter (except if the Board-regulated institution is calculating EAD for a cleared transaction under § 217.133) or contains one or more trades involving illiquid collateral or any derivative contract that cannot be easily replaced. If over the two previous quarters more than two margin disputes on a netting

set have occurred that lasted more than the margin period of risk, then the Board-regulated institution must use a margin period of risk for that netting set that is at least two times the minimum margin period of risk for that netting set. If the periodicity of the receipt of collateral is N-days, the minimum margin period of risk is the minimum margin period of risk under this paragraph (d) plus N minus 1. This period should be extended to cover any impediments to prompt re-hedging of any market risk.

* * * * *

■ 21. Section 217.133 is amended by:

- a. In paragraph (b)(3)(i)(B), removing “§ 217.132(b)(3)(i)(A)” and adding “§ 217.133(b)(3)(i)(A)” in its place.
- b. In paragraph (b)(4)(ii) removing “§ 217.131” and adding “subparts E or F of this part, as applicable” in its place.
- c. Adding paragraph (c)(3)(iii); and
- d. In paragraph (c)(4)(ii) removing “§ 217.131” and adding “subparts E or F of this part, as applicable.” in its place.

The revisions and additions read as follows:

§ 217.133 Cleared transactions.

* * * * *

(c) * * *

(3) * * *

(iii) Notwithstanding paragraphs (c)(3)(i) and (ii) of this section, a clearing member Board-regulated institution may apply a risk weight of 0 percent to the trade exposure amount for a cleared transaction with a CCP where the clearing member Board-regulated institution is acting as a financial intermediary on behalf of a clearing member client, the transaction offsets another transaction that satisfies the requirements set forth in § 217.3(a), and the clearing member Board-regulated institution is not obligated to reimburse the clearing member client in the event of the CCP default.

* * * * *

§ 217.136 [Amended]

■ 22. Section 217.136 is amended by:

- a. In paragraph (e)(2)(i) removing “§ 217.135(e)(1) and (e)(2)” and adding “§ 217.136(e)(1) and (2)” in its place; and
- b. In paragraph (e)(2)(ii) removing “§§ 217.135(e)(1) and (e)(2)” and adding “§ 217.136(e)(1) and (2)” in its place.

- 23. Section 217.172 is amended by revising paragraph (d), as added at 79 FR 57746, September 26, 2014, effective January 1, 2015, to read as follows:

§ 217.172 Disclosure requirements.

* * * * *

(d)(1) A Board-regulated institution that meets any of the criteria in §217.100(b)(1) before January 1, 2015, must publicly disclose each quarter its supplementary leverage ratio and the components thereof (that is, tier 1 capital and total leverage exposure) as calculated under subpart B of this part, beginning with the first quarter in 2015. This disclosure requirement applies without regard to whether the Board-regulated institution has completed the parallel run process and received notification from the Board pursuant to § 217.121(d).

(2) A Board-regulated institution that meets any of the criteria in § 217.100(b)(1) on or after January 1, 2015, must publicly disclose each quarter its supplementary leverage ratio and the components thereof (that is, tier 1 capital and total leverage exposure) as calculated under subpart B of this part beginning with the calendar quarter immediately following the quarter in which the Board-regulated institution becomes an advanced approaches Board-regulated institution. This disclosure requirement applies without regard to whether the Board-regulated institution has completed the parallel run process and has received notification from the Board pursuant to § 217.121(d).

- 24. Section 217.173 is amended by:
 - a. Designating paragraph (a) introductory text, as revised at 79 FR 57746, September 26, 2014, effective January 1, 2015, as (a)(1) and revising it;
 - b. Adding paragraphs (a)(2) and (3);
 - c. Revising the entry for (a)(1) in Table 6 to § 217.173; and
 - d. Revising the entry for (i)(2) in Table 9 to § 217.173.

The revisions and additions read as follows:

§ 217.173 Disclosures by certain advanced approaches Board-regulated institutions.

(a)(1) An advanced approaches Board-regulated institution described in § 217.172(b) must make the disclosures described in Tables 1 through 12 to § 217.173.

(2) An advanced approaches Board-regulated institution that is required to publicly disclose its supplementary leverage ratio pursuant to § 217.172(d) must make the disclosures required under Table 13 to § 217.173, unless the Board-regulated institution is a consolidated subsidiary of a bank holding company, savings and loan holding company, or depository institution that is subject to these disclosures requirements or a subsidiary of a non-U.S. banking organization that is subject to comparable public disclosure requirements in its home jurisdiction.

(3) The disclosures described in Tables 1 through 12 to § 217.173 must be made publicly available for twelve consecutive quarters beginning on January 1, 2014, or a shorter period, as applicable, for the quarters after the Board-regulated institution has completed the parallel run process and received notification from the Board pursuant to section 121(d) of subpart E of this part. The disclosures described in Table 13 to §217.173 must be made publicly available for twelve consecutive quarters beginning on January 1, 2015, or a shorter period, as applicable, for the quarters after the Board-regulated institution becomes subject to the disclosure of the supplementary leverage ratio pursuant to § 217.172(d).

* * * * *

TABLE 6 TO § 217.173—CREDIT RISK: DISCLOSURES FOR PORTFOLIOS SUBJECT TO IRB
RISK-BASED CAPITAL FORMULA

Qualitative disclosures	(a)	* * *
		(1) Structure of internal rating systems and if the Board-regulated institution considers external ratings, the relation between internal and external ratings;
* *	* *	* * *

* * * * *

TABLE 9 TO § 217.173—SECURITIZATION

Quantitative Disclosures	* * *	
* *	* *	* * *
	(i)	* * *
		(2) Aggregate amount disclosed separately by type of underlying exposure in the pool of any: (A) After-tax gain-on-sale on a securitization that has been deducted from common equity tier 1 capital; and (B) Credit-enhancing interest-only strip that is assigned a 1,250 percent risk weight.
* *	* *	* * *

* * * * *

Federal Deposit Insurance Corporation

12 CFR Chapter III

Authority and Issuance

For the reasons stated in the preamble, the Federal Deposit Insurance Corporation proposes to amend part 324 of chapter III of Title 12, Code of Federal Regulations as follows:

PART 324—CAPITAL ADEQUACY

- 25. The authority citation for part 324 continues to read as follows:

Authority: 12 U.S.C. 1815(a), 1815(b), 1816, 1818(a), 1818(b), 1818(c), 1818(t), 1819(Tenth), 1828(c), 1828(d), 1828(i), 1828(n), 1828(o), 1831o, 1835, 3907, 3909, 4808; 5371; 5412; Pub. L. 102-233, 105 Stat. 1761, 1789, 1790 (12 U.S.C. 1831n note); Pub. L. 102-242, 105 Stat. 2236, 2355, as amended by Pub. L. 103-325, 108 Stat. 2160, 2233 (12 U.S.C. 1828 note); Pub. L. 102-242, 105 Stat. 2236, 2386, as amended by Pub. L. 102-550, 106 Stat. 3672, 4089 (12 U.S.C. 1828 note); Pub. L. 111-203, 124 Stat. 1376, 1887 (15 U.S.C. 78o-7 note).

- 26. Section 324.2 is amended by revising the definition of “Residential mortgage exposure” to read as follows:

§ 324.2 Definitions.

* * * *

Residential mortgage exposure means an exposure (other than a securitization exposure, equity exposure, statutory multifamily mortgage, or presold construction loan) that is:

- (1)(i) An exposure that is primarily secured by a first or subsequent lien on one-to-four family residential property; or
- (ii) An exposure with an original and outstanding amount of \$1 million or less that is primarily secured by a first or subsequent lien on residential property that is not one-to-four family; and

(2) For purposes of calculating capital requirements under subpart E of this part, managed as part of a segment of exposures with homogeneous risk characteristics and not on an individual-exposure basis.

* * * * *

- 27. Section 324.10 is amended by revising paragraph (c) introductory text to read as follows:

324.10 Minimum capital requirements.

* * * * *

(c) Advanced approaches capital ratio calculations. An advanced approaches FDIC-supervised institution that has completed the parallel run process and received notification from the FDIC pursuant to § 324.121(d) must determine its regulatory capital ratios as described in paragraphs (c)(1) through (3) of this section. An advanced approaches FDIC-supervised institution must determine its supplementary leverage ratio in accordance with paragraph (c)(4) of this section, beginning with the calendar quarter immediately following the quarter in which the FDIC-supervised institution meets any of the criteria in § 324.100(b)(1).

* * * * *

- 28. Section 324.22 is amended by revising paragraph (b)(1)(iii) to read as follows:

§ 324.22 Regulatory capital adjustments and deductions.

* * * * *

(b) * * *

(1) * * *

(iii) An FDIC-supervised institution must deduct any net gain and add any net loss related to changes in the fair value of liabilities that are due to changes in the FDIC-supervised institution's own credit risk. An advanced approaches FDIC-supervised institution must deduct the difference between its credit spread premium and the risk-free rate for derivatives that are liabilities as part of this adjustment.

* * * * *

- 29. Section 324.100 is amended by revising paragraph (b)(1)(ii) to read as follows:

§ 324.100 Purpose, applicability, and principle of conservatism.

* * * * *

(b) * * *

(1) * * *

(ii) Has consolidated total on-balance sheet foreign exposure on its most recent year-end Call Report equal to \$10 billion or more (where total on-balance sheet foreign exposure equals total foreign countries cross-border claims on an ultimate-risk basis, plus total foreign countries claims on local residents on an ultimate-risk basis, plus total foreign countries fair value of foreign exchange and derivative products), calculated in accordance with the Federal Financial Institutions Examination Council (FFIEC) 009 Country Exposure Report;

* * * * *

- 30. Section 324.122 is amended by:
 - a. Revising paragraphs (a)(3) and (b)(1);
 - b. Adding paragraph (b)(2)(iii);
 - c. Revising paragraphs (b)(3) and (5) and (c)(1), (2), (5), and (6);
 - d. Redesignating paragraphs (c)(9) and (10) as paragraphs (c)(10) and (11), revising them, and adding a new paragraph (c)(9).
 - e. Revising paragraph (i)(5).

The revisions and additions read as follows:

§324.122 Qualification requirements.

(a) * * *

(3) Each FDIC-supervised institution must have an appropriate infrastructure with risk measurement and management processes that meet the qualification requirements of this section and are appropriate given the FDIC-supervised institution's size and level of complexity. Regardless of whether the systems and models that generate the risk parameters necessary for calculating an FDIC-supervised institution's risk-based capital requirements are located at any affiliate of the FDIC-supervised institution, the FDIC-supervised institution itself must ensure that the risk parameters and reference data used to determine its risk-based capital requirements are representative of long run experience with respect to its own credit risk and operational risk exposures.

(b) Risk rating and segmentation systems for wholesale and retail exposures.

(1)(i) An FDIC-supervised institution must have an internal risk rating and segmentation system that accurately, reliably, and meaningfully differentiates among degrees of credit risk for the FDIC-supervised institution's wholesale and retail exposures. When assigning an internal risk rating, an FDIC-supervised institution may consider a third-party assessment of credit risk, provided that the FDIC-supervised institution's internal risk rating assignment does not rely solely on the external assessment.

(ii) If an FDIC-supervised institution uses multiple rating or segmentation systems, the FDIC-supervised institution's rationale for assigning an obligor or exposure to a particular system must be documented and applied in a manner that best reflects the obligor or exposure's level of risk. An FDIC-supervised institution must not inappropriately allocate obligors across systems to minimize regulatory capital requirements.

(iii) In assigning ratings to wholesale obligors and exposures, including loss severity ratings grades to wholesale exposures, and assigning retail exposures to retail segments, an FDIC-supervised institution must use all relevant and material information and ensure that the information is current.

(iv) When assigning an obligor to a PD rating or retail exposure to a PD segment, an FDIC-supervised institution must assess the obligor or retail borrower's ability and willingness to contractually perform, taking a conservative view of projected information.

(2) * * *

(iii) An FDIC-supervised institution must have an effective process to obtain and update in a timely manner relevant and material information on obligor and exposure characteristics that affect PD, LGD and EAD.

(3) For retail exposures:

(i) An FDIC-supervised institution must have an internal system that groups retail exposures into the appropriate retail exposure subcategory and groups the retail exposures in each retail exposure subcategory into separate segments with homogeneous risk characteristics that provide a meaningful differentiation of risk. The FDIC-supervised institution's system must identify and group in separate segments by subcategories exposures identified in § 324.131(c)(2)(ii) and (iii).

(ii) An FDIC-supervised institution must have an internal system that captures all relevant exposure risk characteristics, including borrower credit score, product and collateral types, as well as exposure delinquencies, and must consider cross-collateral provisions, where present.

(iii) The FDIC-supervised institution must review and, if appropriate, update assignments of individual retail exposures to segments and the loss characteristics and delinquency status of each identified risk segment. These reviews must occur whenever the FDIC-supervised institution receives new material information, but generally no less frequently than quarterly, and, in all cases, at least annually.

* * * * *

(5) The FDIC-supervised institution's internal risk rating system for wholesale exposures must provide for the review and update (as appropriate) of each obligor rating

and (if applicable) each loss severity rating whenever the FDIC-supervised institution obtains relevant and material information on the obligor or exposure that affect PD, LGD and EAD, but no less frequently than annually.

(c) Quantification of risk parameters for wholesale and retail exposures. (1) The FDIC-supervised institution must have a comprehensive risk parameter quantification process that produces accurate, timely, and reliable estimates of the risk parameters on a consistent basis for the FDIC-supervised institution's wholesale and retail exposures.

(2) An FDIC-supervised institution's estimates of PD, LGD, and EAD must incorporate all relevant, material, and available data that is reflective of the FDIC-supervised institution's actual wholesale and retail exposures and of sufficient quality to support the determination of risk-based capital requirements for the exposures. In particular, the population of exposures in the data used for estimation purposes, and lending standards in use when the data were generated, and other relevant characteristics, should closely match or be comparable to the FDIC-supervised institution's exposures and standards. In addition, an FDIC-supervised institution must:

(i) Demonstrate that its estimates are representative of long run experience, including periods of economic downturn conditions, whether internal or external data are used;

(ii) Take into account any changes in lending practice or the process for pursuing recoveries over the observation period;

(iii) Promptly reflect technical advances, new data, and other information as they become available;

(iv) Demonstrate that the data used to estimate risk parameters support the accuracy and robustness of those estimates; and

(v) Demonstrate that its estimation technique performs well in out-of-sample tests whenever possible.

* * * * *

(5) The FDIC-supervised institution must be able to demonstrate which variables have been found to be statistically significant with regard to EAD. The FDIC-supervised institution's EAD estimates must reflect its specific policies and strategies with regard to account management, including account monitoring and payment processing, and its ability and willingness to prevent further drawdowns in circumstances short of payment default. The FDIC-supervised institution must have adequate systems and procedures in place to monitor current outstanding amounts against committed lines, and changes in outstanding amounts per obligor and obligor rating grade and per retail segment. The FDIC-supervised institution must be able to monitor outstanding amounts on a daily basis.

(6) At a minimum, PD estimates for wholesale obligors and retail segments must be based on at least five years of default data. LGD estimates for wholesale exposures must be based on at least seven years of loss severity data, and LGD estimates for retail segments must be based on at least five years of loss severity data. EAD estimates for wholesale exposures must be based on at least seven years of exposure amount data, and EAD estimates for retail segments must be based on at least five years of exposure amount data. If the FDIC-supervised institution has relevant and material reference data

that span a longer period of time than the minimum time periods specified above, the FDIC-supervised institution must incorporate such data in its estimates, provided that it does not place undue weight on periods of favorable or benign economic conditions relative to periods of economic downturn conditions.

* * * * *

(9) If an FDIC-supervised institution uses internal data obtained prior to becoming subject to this subpart E or external data to arrive at PD, LGD, or EAD estimates, the FDIC-supervised institution must demonstrate to the FDIC that the FDIC-supervised institution has made appropriate adjustments if necessary to be consistent with the definition of default in § 324.101. Internal data obtained after the FDIC-supervised institution becomes subject to this subpart E must be consistent with the definition of default in § 324.101.

(10) The FDIC-supervised institution must review and update (as appropriate) its risk parameters and its risk parameter quantification process at least annually.

(11) The FDIC-supervised institution must, at least annually, conduct a comprehensive review and analysis of reference data to the FDIC-supervised institution's exposures, quality of reference data to support PD, LGD, and EAD estimates, and consistency of reference data to the definition of default in § 324.101.

* * * * *

(i) * * *

(5) The FDIC-supervised institution must have an internal audit function or equivalent function that is independent of business-line management that at least annually:

(i) Reviews the FDIC-supervised institution's advanced systems and associated operations, including the operations of its credit function and estimations of PD, LGD, and EAD;

(ii) Assesses the effectiveness of the controls supporting the FDIC-supervised institution's advanced systems; and

(iii) Documents and reports its findings to the FDIC-supervised institution's board of directors (or a committee thereof).

* * * * *

■ 31 Section 324.131 is amended by:

■ a. Revising paragraph (d)(5)(ii) and (iii); and

■ b. In paragraph (e)(3)(vi), removing “§ 324.22(a)(7)” and adding “§ 324.22(d)” in its place.

The revisions read as follows:

§324.131 Mechanics for calculating total wholesale and retail risk-weighted assets.

* * * * *

(d) * * *

(5) * * *

(ii) An FDIC-supervised institution may take into account the risk reducing effects of guarantees and credit derivatives in support of retail exposures in a segment when quantifying the PD and LGD of the segment. In doing so, an FDIC-supervised institution must consider all relevant available information.

(iii) Except as provided in paragraph (d)(6) of this section, an FDIC-supervised institution may take into account the risk reducing effects of collateral in support of a wholesale exposure when quantifying the LGD of the exposure, and may take into account the risk reducing effects of collateral in support of retail exposures when quantifying the PD and LGD of the segment. In order to do so, an FDIC-supervised institution must have established internal requirements for collateral management, legal certainty, and risk management processes.

* * * * *

■ 32. Section 324.132 is amended by:

- a. In Table 1 to § 324.132, removing “this section” and adding “§ 324.32” in its place, wherever it appears;
- b. Revising paragraphs (c)(1) and (d)(5)(iii)(B);

- c. In paragraph (d)(7)(iv)(B), removing “§ 324.131(b)(2)” and adding “§ 324.132(b)(2)” in its place; and
- d. In paragraph (d)(9)(ii), removing “paragraph (e)(3)” and adding “paragraph (e)(6)” in its place.

The revisions read as follows:

§ 324.132 Counterparty credit risk of repo-style transactions, eligible margin loans, and OTC derivative contracts.

* * * *

(c) EAD for OTC derivative contracts — (1) OTC derivative contracts not subject to a qualifying master netting agreement. An FDIC-supervised institution must determine the EAD for an OTC derivative contract that is not subject to a qualifying master netting agreement using the current exposure methodology in paragraph (c)(5) of this section or using the internal models methodology described in paragraph (d) of this section. An FDIC-supervised institution may reduce the EAD calculated according to paragraphs (c)(5) or (d) of this section by the credit valuation adjustment that the FDIC-supervised institution has recognized in its balance sheet valuation of any OTC derivative contracts in the netting set. For purposes of this paragraph (c), the credit valuation adjustment does not include any adjustments to common equity tier 1 capital attributable to changes in the fair value of the FDIC-supervised institution’s liabilities that are due to changes in its own credit risk since the inception of the transaction with the counterparty.

* * * * *

(d) * * *

(5) * * *

(iii) * * *

(B) Twenty business days if the number of trades in a netting set exceeds 5,000 at any time during the previous quarter (except if the FDIC-supervised institution is calculating EAD for a cleared transaction under § 324.133) or contains one or more trades involving illiquid collateral or any derivative contract that cannot be easily replaced. If over the two previous quarters more than two margin disputes on a netting set have occurred that lasted more than the margin period of risk, then the FDIC-supervised institution must use a margin period of risk for that netting set that is at least two times the minimum margin period of risk for that netting set. If the periodicity of the receipt of collateral is N-days, the minimum margin period of risk is the minimum margin period of risk under this paragraph (d) plus N minus 1. This period should be extended to cover any impediments to prompt re-hedging of any market risk.

* * * * *

- 33. Section 324.133 is amended by:
 - a. In paragraph (b)(3)(i)(B), removing “§ 324.132(b)(3)(i)(A)” and adding “§ 324.133(b)(3)(i)(A)” in its place;
 - b. In paragraphs (b)(4)(ii) removing “§ 324.131” and adding “subparts E or F of this part, as applicable” in its place;
 - c. Adding paragraph (c)(3)(iii); and
 - d. In paragraph (c)(4)(ii) removing “§ 324.131” and adding “subparts E or F of this part, as applicable” in its place.

The addition reads as follows:

§ 324.133 Cleared transactions.

* * * * *

(c) * * *

(3) * * *

(iii) Notwithstanding paragraphs (c)(3)(i) and (ii) of this section, a clearing member FDIC-supervised institution may apply a risk weight of 0 percent to the trade exposure amount for a cleared transaction with a CCP where the clearing member FDIC-supervised institution is acting as a financial intermediary on behalf of a clearing member client, the transaction offsets another transaction that satisfies the requirements set forth in § 324.3(a), and the clearing member FDIC-supervised institution is not obligated to reimburse the clearing member client in the event of the CCP default.

* * * * *

§ 324.136 [Amended]

- 34. Section 324.136 is amended by,
 - a. In paragraph (e)(2)(i) removing “§ 324.135(e)(1) and (e)(2)” and adding “§ 324.136(e)(1) and (2)” in its place; and
 - b. In paragraph (e)(2)(ii), removing “§§ 324.135(e)(1) and (e)(2)” and adding “§ 324.136(e)(1) and (2)” in its place.

- 34. Section 324.172 is amended by revising paragraphs (d), as added at 79 FR 57750, September 26, 2014, effective January 1, 2015, to read as follows:

§ 324.172 Disclosure requirements.

* * * * *

(d) (1) An FDIC-supervised institution that meets any of the criteria in §324.100(b)(1) before January 1, 2015, must publicly disclose each quarter its supplementary leverage ratio and the components thereof (that is, tier 1 capital and total leverage exposure) as calculated under subpart B of this part, beginning with the first quarter in 2015. This disclosure requirement applies without regard to whether the FDIC-supervised institution has completed the parallel run process and received notification from the FDIC pursuant to § 324.121(d).

(2) An FDIC-supervised institution that meets any of the criteria in § 324.100(b)(1) on or after January 1, 2015, must publicly disclose each quarter its supplementary leverage ratio and the components thereof (that is, tier 1 capital and total leverage exposure) as calculated under subpart B of this part beginning with the calendar quarter immediately following the quarter in which the FDIC-supervised institution becomes an advanced approaches FDIC-supervised institution. This disclosure requirement applies without regard to whether the FDIC-supervised institution has

completed the parallel run process and has received notification from the FDIC pursuant to § 324.121(d).

- 35. Section 324.173 is amended by:
 - a. Designating paragraph (a), as revised at 79 FR 57750, September 26, 2014, effective January 1, 2015, as paragraph (a)(1) and revising it;
 - b. Adding paragraphs (a)(2) and (3);
 - c. Revising the entry for (a)(1) in Table 6 to § 324.173; and
 - d. Revising the entry for (i)(2) in Table 9 to § 324.173.

The revisions and additions read as follows:

§324.173 Disclosures by certain advanced approaches FDIC-supervised institutions.

(a)(1) An advanced approaches FDIC-supervised institution described in § 324.172(b) must make the disclosures described in Tables 1 through 12 to § 324.173.

(2) An advanced approaches FDIC-supervised institution that is required to publicly disclose its supplementary leverage ratio pursuant to § 324.172(d) must make the disclosures required under Table 13 to § 324.173, unless the FDIC-supervised institution is a consolidated subsidiary of a bank holding company, savings and loan holding company, or depository institution that is subject to these disclosures requirements or a subsidiary of a non-U.S. banking organization that is subject to comparable public disclosure requirements in its home jurisdiction.

(3) The disclosures described in Tables 1 through 12 to § 324.173 must be made publicly available for twelve consecutive quarters beginning on January 1, 2014, or a shorter period, as applicable, for the quarters after the FDIC-supervised institution has completed the parallel run process and received notification from the FDIC pursuant to section 121(d) of subpart E of this part. The disclosures described in Table 13 to § 324.173 must be made publicly available for twelve consecutive quarters beginning on January 1, 2015, or a shorter period, as applicable, for the quarters after the FDIC-supervised institution becomes subject to the disclosure of the supplementary leverage ratio pursuant to § 324.172(d).

* * * * *

TABLE 6 TO § 324.173—CREDIT RISK: DISCLOSURES FOR PORTFOLIOS SUBJECT TO IRB
RISK-BASED CAPITAL FORMULA

Qualitative disclosures	(a)	<p>* * *</p> <p>(1) Structure of internal rating systems and if the national bank or the FDIC-supervised institution considers external ratings, the relation between internal and external ratings;</p> <p>* * *</p>
* *	* *	* * *

* * * * *

TABLE 9 TO § 324.173—SECURITIZATION

* *	* *	* * *
Quantitative disclosures	* * *	* * *
	(i)	<p>* * *</p> <p>(2) Aggregate amount disclosed separately by type of underlying exposure in the pool of any: (A) After-tax gain-on-sale on a securitization that has been deducted from common equity tier 1 capital; and (B) Credit-enhancing interest-only strip that is assigned a 1,250 percent risk weight.</p>
* *	* *	* * *

* * * * *

Dated: November 18, 2014.

Thomas J. Curry,

Comptroller of the Currency.

By order of the Board of Governors of the Federal Reserve System, December 2, 2014.

Robert deV. Frierson

Secretary of the Board.

Dated at Washington, D.C., this 18th day of November, 2014.

By order of the Board of Directors.

Federal Deposit Insurance Corporation.

Robert E. Feldman,

Executive Secretary.

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